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IMPROVING GOVERNMENT

GAO's Views on H.R. 3400 Management Initiatives

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Mr. Chairman and Members of the Committee:

It is a pleasure to appear before you today to discuss key management aspects of H.R. 3400, the Government Reform and Savings Act of 1993. In 17 separate titles and over 70 provisions, H.R. 3400 makes a host of specific legislative proposals covering a wide range of topics, from those related to improving individual agency operations to furthering broad-based governmentwide initiatives. Today, as you requested, I will focus my remarks on those sections of the legislation that concern financial management, general management and human resource management.

Most of these management proposals emanate from the Vice President's major National Performance Review (NPR). They are directed at moving toward a smaller, more efficient government which stresses accountability and managing for results. As I emphasized in my testimony last month before this Committee on sustaining and enhancing management reforms, I am very encouraged by recent actions by the Congress and the administration to move in this direction.

Consequently, we are generally supportive of the thrust of the proposed management improvement sections of H.R. 3400. I will point out certain provisions today, especially the requirement for audited financial statements for the government's largest 23 departments and agencies, that are vital to meaningful management reform and should be swiftly enacted. In a few cases, especially in the franchise and innovation funds area, we have serious reservations about the provisions as now structured in the bill and see the need for more deliberation and consideration of alternative courses of action. And, finally, we have a number of refinements to individual sections that we will offer and one suggestion for an additional provision focused on preparing and auditing a much-needed consolidated picture of the federal government's financial condition.

REQUIRING AUDITED FINANCIAL STATEMENTS FOR ALL MAJOR AGENCIES

Let me first turn to the area of expanding the Chief Financial Officers (CFO) Act's requirement for audited financial statements, contained in Section 16005 of H.R. 3400. Enacting this provision is essential to enhancing ongoing financial management reforms to ensure basic accountability and produce the facts needed to run our government effectively. It is absolutely critical that we expand and make permanent the CFO Act's audited financial statement requirements for all major departments and agencies. As discussed in our 1988 and 1992 transition reports on financial management, unless we achieve success here, our leaders will continue to be crippled in their ability to control costs, evaluate performance, or adequately implement calls for broader management improvements.

The CFO Act, sponsored by this Committee, provides the blueprint for essential financial management reform. Since its enactment in late 1990, we have seen important progress in directly confronting serious financial management weaknesses. In particular, the act's requirement for producing annual audited financial statements on a pilot basis is demonstrating its value in many important ways.

First, a much clearer picture is emerging of the government's true financial condition. On the revenue side, our financial audits of the Internal Revenue Service (IRS) and the U.S. Customs Service concluded that there is little assurance that the government is collecting all the money due or accurately accounting for the estimated $1.1 trillion it receives annually. Financial audits also have provided a much more realistic portrayal of the costs the government can expect to incur as a result of its activities. The audits have highlighted tens of billions of dollars in liabilities and potential losses to the government from its wide variety of activities, such as education and housing loan programs, pension benefit requirements, and hazardous waste cleanup.

This is the kind of information needed to make critical decisions on the budget, tax policies, and the overall direction of government programs. Moreover, as members of this Committee can fully appreciate, after making wrenching budgetary decisions to curb the growth of the deficit, it is disheartening to find such efforts undermined by the unwelcome surprise of huge hidden costs. Tough budget decisions will continue to be even harder without better, more complete information on the costs and consequences of government programs and activities.

Next, in addition to shedding more light on the government's fiscal posture, audited financial statements have brought much needed discipline in pinpointing waste, mismanagement, and possible illegal acts and in highlighting the gaps in safeguarding the government's assets. For example, our financial audit found that people no longer serving in the Army were, nevertheless, paid over $6 million because their names were not removed from active duty payroll files.

Third, CFO Act financial audits have identified actual and potential savings of hundreds of millions of dollars. For instance, at DOD alone over $204 million was identified in potential savings from duplicate invoices and payments and avoided interest.

Finally, the financial audits are confirming just how little confidence the Congress and program managers can place in the information they now receive. We have identified hundreds of billions of dollars of accounting errors--mistakes and omissions that can render information provided to managers and the Congress virtually useless. Identifying and quantifying these inaccuracies is a necessary first step in improving the quality of information for legislative and executive decisionmakers.

This view was echoed by the CFO and inspector general (IG) communities. In commenting on the results of the CFO Act financial audits to this Committee, agency CFOs and IGs reported that the process of preparing and auditing financial statements brings much needed rigor to accounting and financial reporting and highlights where the real problems are. They also expressed their view that the full benefits of preparing and auditing financial statements are yet to be achieved.

The CFOs and IGs have concluded that the benefits of preparing and auditing financial statements far outweigh the costs. For fiscal year 1992, the Office of Management and Budget (OMB) and the agencies reported the cost of preparing and auditing financial statements under the CFO Act to be about $111 million. These costs represent only about one-tenth of 1 percent of the total budget authority audited under the CFO Act. It is important to recognize also that many of these costs were for first-ever audits where one-time start-up costs were incurred. Based on our experience in performing major financial audits, we anticipate that the cost of these audits will decline over time.

Even in the short term, however, this first-year investment has paid handsome dividends. Overall, the benefits of CFO Act audits have overshadowed their costs. As with any well-operated enterprise, the investment in audited financial statements is an essential business practice. To assist the Committee, attached to this testimony is a detailed summary of the benefits and costs associated with financial statement audits under the CFO Act.

Expanding the Requirement for Audited Financial Statements

Section 16005 of H.R. 3400 would expand the existing requirement for agency level audited financial statements to all 23 CFO Act agencies. Presently, the act only requires agencies to prepare audited financial statements for commercial-type activities, such as credit and insurance programs, and for trust and revolving funds. Also, the act created a pilot program to test the viability of preparing and auditing financial statements for the entire operations of 10 major organizations. These pilots encompass a range of government activities from the Army and Air Force to revenue collection agencies--IRS and Customs--to cabinet departments such as the Departments of Housing and Urban Development, Labor, Agriculture, and Veterans Affairs.

CFO Act financial audits now cover only about 60 percent of the government's budget authority and relatively few agencies on an overall basis. As a result of the act's limited scope, major segments of the federal government's operations have not had the benefit of a financial audit, including

-- over $200 billion in Medicare and Medicaid benefit payments;

-- about $16 billion, or about 63 percent, of Energy's annual obligations accounted for by its integrated contractors;

-- about $90 billion appropriated to the Navy;

-- about $6 billion in Education's Pell grant programs; and

-- more than $11 billion, or nearly 90 percent, of the Department of Justice's budget authority.

To fill gaps such as these, we urge the Congress to enact the provisions of H.R. 3400 that expand audited financial statement requirements. Our support is based on the solid record of the CFO Act pilots, which have been tremendously successful. Many benefits we have highlighted today, and in previous testimonies before this Committee, have been generated from the pilot program. OMB's Director agrees with this assessment and reported to the Congress last November that the pilot program has been successful.

The concept of financial audits has also gained support from other agency leaders. For example, the IRS Commissioner expressed support for this concept last August in testimony before this Committee. She stated the following:

> "First and foremost, based on our experience with the recent GAO audit, we believe that all government agencies should prepare annual financial statements and have them audited. Our experience has been that the benefits of systematically identifying problems and measuring progress are truly significant. In addition, as I have stated earlier, the real value of audited financial statements is the comprehensive view they provide of the financial management issues that confront the IRS in effectively and efficiently running our operations."

Moreover, implementation of uniform requirements for audited financial statements has been a cornerstone of management improvement efforts of state and local governments and some other countries. State and local governments have found that mandated annual audited financial statements are important catalysts for achieving financial management improvements and for producing quality information to assist decision-making, provide basic accountability, and track progress. Governments in other countries who have undergone reinvention initiatives used this same model and made audited financial statements an essential part of the management process.

Similarly, the success of current U.S. management reform initiatives, such as the Government Performance and Results Act, will rest heavily upon having audited financial data. Under this act, it will be essential to have reliable financial information to fully assess the results of federal programs and to establish future strategies.

While fully supporting Section 16005 of H.R. 3400, I suggest it be refined to make it clear the Congress expects that the major components of agencies will also have audited financial statements under the CFO Act. Within the Department of Defense, for example, it is critical for audited financial statements to be separately prepared for the Army, Navy, and Air Force. Examples of major components of other departments that should have audited financial statements include the Social Security Administration (SSA), IRS, and the U.S. Customs Service.

Many agencies are comprised of multiple components that are responsible for carrying out different missions, operate unique programs, and are managed as separate entities, some financially larger than most U.S. corporations. Separate financial statements for component-level entities are essential to providing relevant financial facts related specifically to their distinctive operations. To further clarify this point, we will work with OMB to provide the Committee a listing of agency components for which financial statements should be prepared and audited.

Also, we note that Section 16005 of H.R. 3400 moves forward the time frame for agencies to prepare and submit agency-level audited financial statements to OMB. The CFO Act presently requires the statements to be prepared and submitted by June 30; H.R. 3400 would require that agency-level audited financial statements be prepared and submitted by March 1. We believe that accelerating the CFO Act's time frame is essential so that audited financial statement information is available as early as possible to assist congressional budget deliberations.

Requiring Audited Governmentwide Financial Reports

The time has also come for an audited governmentwide financial report that would provide the Congress and the American public with a complete picture of where its government stands financially. Our federal government is the world's largest financial operation. Yet, it operates without ever knowing its overall financial status--a situation that would be short-lived in state and local governments or the private sector. Today, state and local governments have adopted, across the board, the concept of financial audits as a key management tool, and it is a common practice in corporate America and other major countries. While its mission is vastly different, the federal government also has a responsibility to provide meaningful governmentwide financial reports.

Requiring governmentwide audited financial statements is another area where we and the administration agree. The NPR calls for a consolidated annual report on the finances of the federal government and established 1997 as the first year to have these statements audited. NPR also calls for the Department of the Treasury to prepare a simplified version of the consolidated statements--referred to as the "Annual Accountability Report to the Citizens"--for distribution to the public so that it receives an accounting of the moneys spent and its effects on achieving the government's goals.

With information that brings together in one place the results of operating each agency's program, decisionmakers would have the tools to (1) better understand the issues the government faces and the implications of past decisions and (2) better manage scarce resources once those decisions are made. The government cannot be counted on to make sound decisions in a financial information vacuum. To fill the void and make decisions in an informed manner, the right financial data must be in the hands of decisionmakers--the Congress and other top administration people--who are expected to make the hard choices affecting the lives and livelihoods of every American citizen.

In large part, the answer lies in having available agency-level financial statements, but the missing link continues to be financial statements that show a composite snapshot of financial results across government. Consolidated governmentwide financial statements would provide a wealth of critical information about government that is not available anywhere else and that would go well beyond what would be prepared if the requirement for financial statements were limited to agency-level reporting.

The American public wants to believe in our government and trust its decisions. In the taxpayers' eyes, there is no substitute for accountability. Reliable consolidated governmentwide financial reports that are easy to understand could provide the high-level credible information needed to help restore confidence in government.

These annual reports, which GAO would audit each year, would provide needed information to the Congress and the executive branch in assessing the government's financial status. Among the questions that these reports could answer would be whether the government's financial position improved or deteriorated over the period and whether future budgetary resources are likely to be sufficient to sustain public services and meet future obligations as they come due.

We believe it would be best for this requirement to be anchored in legislation. While administrative requirements to prepare annual financial statements go back to the 1950s, the legal force of the CFO Act, together with the interest of this Committee, is what finally moved this effort ahead. Thus, in addition to the requirement for a permanent program of agency-level financial statements, it is important that H.R. 3400 be expanded to require annual audited governmentwide financial reports. We will provide the appropriate legislative language to the Committee should it choose to add this important requirement.

FRANCHISE AND INNOVATION FUNDS

Mr. Chairman, you also asked for my comments on Section 16003 of H.R. 3400, which would permit any executive agency, with the concurrence of OMB, to create franchise funds and innovation funds without further appropriation action by the Congress.

The proposals to establish franchise and innovation funds seek to advance--explicitly or implicitly--several goals: (1) to encourage the centralized provision of administrative support services where such centralization would increase efficiency, (2) to create competition in the provision of these services as a way of encouraging economies, (3) to promote increased user awareness of the cost of support services, and (4) to provide investment capital to improve administrative support services and management innovations in operational program areas.

Centralization, competition and cost awareness, and adequate capital for innovation could help the government use technology more effectively and strengthen and modernize its support services. Unless ways are found to improve these basic underpinnings, the government will fall short of achieving many of the NPR objectives and curing some of the serious problems revealed by CFO Act audits. The government needs, and we have supported, centralized administrative support services and cross-servicing arrangements for common problems. Agencies should not have to develop independently, with their own separate resources, common systems and services. The government needs to find better ways to share and access scarce technical abilities.

However, in examining these specific proposals in Section 16003, three questions arise. First, how do these funding mechanisms compare to those already available to executive departments? Second, what is the likelihood that these budget mechanisms will achieve the objectives cited by NPR, OMB, and others? And, third, what implications do these proposals have for legislative oversight and control?

Based on preliminary results from work we are currently doing for this Committee, we believe that there are serious questions about the proposals. It is not at all clear that a new budget mechanism must be created or that such mechanisms will necessarily achieve the goals outlined in these proposals.

The Congress has already created specific budgetary accounts that share the essential characteristics of the proposed franchise and innovation funds. Although they go by a variety of names--working capital funds, business operations funds, revolving funds--they are comparable to the funds envisioned in Section 16003 of H.R. 3400. They serve similar purposes, are available until spent, and are intended to be self-sustaining, relying on reimbursements by the users of the services. Reimbursements received by the funds are then available for use without further appropriation action.

Based on the work we have done to date, all executive departments already have at least one budget account to support centralized administrative services on a reimbursable basis. The Departments of Education and Energy have specific statutory authority to establish such accounts, but have not done so. In fiscal year 1992, the Department of Defense consolidated several industrial and stock revolving funds into the Defense Business Operations Fund, which had gross outlays in fiscal year 1993 of about $53 billion.

In fiscal year 1993, the principal accounts serving non-defense executive departments had gross outlays of over $2 billion dollars and showed varying patterns of use. Gross outlays and unobligated balances for these accounts have experienced average annual growth rates of 3.3 percent and 10.2 percent, respectively, since fiscal year 1981. In some cases, the accounts show negative growth rates for gross outlays or unobligated balances, or both, indicating reduced use over time by the department. Lastly, unobligated balances, which may be spent without further appropriation action, have grown as a percent of gross outlays from 6.4 percent in fiscal year 1981 to 13.9 percent in fiscal year 1993.

H.R. 3400 seeks to encourage the economic provision of services by promoting franchising of common administrative services. However, most of the existing accounts already have specific authority to provide such services to other units within their departments and to other federal agencies. For example, the National Finance Center--supported by the Department of Agriculture working capital fund--provides a variety of centralized administrative systems and services (e.g., payroll, personnel, supply, inventory, property, and travel) both to its parent agency and to others, including GAO and the Departments of Treasury and Justice.

Although our study of these funds has not been completed, an initial review of numerous financial audits and GAO and IG reviews indicate that these funds have generally not been operated very well. In some instances, poor operation of the funds has contributed to losses. These losses result in the need for additional subsidies, either (1) through current or future appropriations, which suggests that these funds are not self-sustaining, or (2) by charging higher fees or prices for the services provided, which can inhibit the capacity of the funds to effectively compete. Nevertheless, some funds seemed to be operating as expected. A more detailed assessment, though, is needed to determine whether these existing funding mechanisms are achieving the objectives associated with the proposed franchise and innovation funds.

This brings us to the third--and perhaps most important--question: What implications do the proposals in Section 16003 have for legislative oversight and control? The H.R. 3400 proposals contain several provisions which would fundamentally alter legislative/executive relationships.

-- First, both the franchise and innovation funds could be created at the discretion of an agency head, with the concurrence of OMB. No further congressional action would be required.

-- Second, the funds would be capitalized during their first 3 years by the transfer of up to 50 percent of the unobligated balances of annual appropriations--"salary and expense" appropriations for franchise funds and "other than salary and expense" appropriations for innovation funds. Moneys transferred under this authority would otherwise be in expired accounts and unavailable for new obligations. This blanket transfer authority would allow the executive branch to move funds from one purpose to another and convert these funds to no-year money available for obligation without time limitation.

-- Third, in the case of franchise funds, the fund would be allowed to recover the actual costs of operation and "to maintain a reasonable operating reserve, as determined by the head of the agency." Thus, the executive branch determines how much money the fund will earn and how much it will accumulate over time.

The goals articulated for the franchise and innovation funds are laudable. I certainly believe the government must find ways to encourage and finance efforts to reduce the cost of delivering government services. However, it is unclear why existing working capital funds, or other similar budgetary mechanisms, could not be used to fund agency efforts to improve administrative efficiency or promote innovations.

Our preliminary work suggests that these existing mechanisms are providing such services but are also experiencing persistent problems, especially with respect to being fully self-sustaining. Allowing these funding mechanisms access to otherwise expired budget authority, as proposed for franchise and innovation funds, would raise serious questions for legislative oversight and control and be a significant departure from current account closing procedures.

Before enacting government-wide legislation to create franchise and innovation funds, there needs to be a thorough examination of existing funds and how they work. This analysis would provide information concerning what, if any, changes in the structure and authorities of these accounts may be needed to advance the NPR objectives without sacrificing congressional oversight and control over appropriated funds. One possible alternative approach is to continue the practice of providing for such funds in specific departments and agencies with congressional participation.

ADDRESSING OTHER H.R. 3400 FINANCIAL MANAGEMENT IMPROVEMENTS

H.R. 3400 proposes several other financial management provisions. Through these provisions, the administration seeks to (1) increase the use of technology for financial services, (2) increase the collection of debts owed the government, and (3) streamline management and financial reports.

Using Electronic Technology for Certain Payments

Section 16002 of H.R. 3400 would require electronic funds transfer of federal wage, salary, and retirement payments unless the recipient or agency head explicitly requests an exception. The requirement applies only to recipients whose payments begin on or after January 1, 1995. The NPR proposed that this be done to increase the use of technology to streamline financial services.

We strongly agree that substantial benefits are to be gained through the increased use of technology in financial operations, including electronic funds transfers, and fully support the increased use of technology where feasible. Many recipients of the payments specified in H.R. 3400 already use electronic funds transfers as an efficient and effective payment method. Also, many other types of payments can and are being made through electronic funds transfers, including payments between agencies and to state and local governments.

Strengthening Debt Collection Procedures

In the past, we have supported legislative action to enhance agencies' credit management and debt collection programs. Along these lines, H.R. 3400 contains a series of technical clarifications to improve debt collection and related practices.

-- Section 16010 would require agencies to adjust civil monetary penalties for inflation by September 30, 1994, and at least once every 4 years thereafter. We believe this proposal has considerable merit and note that the Congressional Budget Office estimates this action would produce $54 million in revenues.

-- Section 16009 would eliminate a requirement of the pilot program to use private attorneys to collect debts owed to the government as authorized by the Debt Collection Amendments Act of 1986 (Public Law 99-578). The pilot extends through fiscal year 1996 and requires the Attorney General to use "best efforts to" contract for legal services with at least four firms in each judicial district participating in the program. Because the volume of debt cases under the program has declined, the judicial district requirement has affected the program's profitability to private attorneys and their willingness to participate in the pilot program. Section 16009 proposes eliminating the prescribed minimum number of contracts. We agree with the thrust of this proposal, which would allow the Attorney General flexibility to contract with private attorneys commensurate with the volume of debt cases involved.

-- Under present law, when Treasury reduces a tax refund to satisfy a debt to another agency, Treasury is required to notify the agency of the debtor's home address. Section 16008 would change this to require Treasury to notify the agency of the debtor's mailing address. We endorse this action as a means of assisting agencies in better managing credit program operations.

There are some issues presented by two other debt collection provisions which I would like to briefly discuss. First, Section 16006 provides some authority for debt collection activities to be funded by revenues from collections. This section would authorize agencies to retain up to 1 percent of delinquent debts collected in a fiscal year and up to 10 percent of any "sustained annual increase in delinquent debt collections" (as defined by OMB) to enhance debt collection activities. The amount an agency actually would be able to retain and use would be determined by appropriations acts. Section 16006 does not apply to debt collection involving the Department of Justice. In the past, we have suggested that the Congress consider providing this type of incentive to agencies to improve debt collection practices and systems. However, we are concerned that agencies will not have accurate baseline data from which to determine the first "sustained increase in delinquent debt collections."

Second, Section 16007 would extend existing authority in the Debt Collection Act of 1982 that allow agencies to contract for debt collection services to the Customs Service for debts owed under the tariff laws and to SSA for debts owed by persons not receiving benefits under the Social Security Act. Our financial audit of the Customs Service addressed the need to lift the legislative restriction on the Customs Service's use of collection agencies to collect amounts owed to the government, which the Debt Collection Act authorizes other agencies to use.

Also, Section 16007 would extend existing authority to exchange information with consumer reporting agencies when trying to collect claims by the government to claims under the tariff laws and the Social Security Act. We have reported that SSA has not used consumer credit bureaus to locate former beneficiaries who owe debts to SSA because claims under the Social Security Act are presently excluded from some Debt Collection Act provisions. Unlike the proposed changes regarding the use of collection services, the proposed change regarding the use of consumer reporting agencies would appear to apply to claims against persons receiving benefits under the Social Security Act.

Simplifying the Management Reporting Process

Sections 15001 and 16004 authorize OMB to publish recommendations annually in the budget for consolidating, eliminating, or changing the due dates and frequency of statutorily required periodic general management and financial management reports. This would apply to agency reports to OMB or the President, as well as executive branch reports to the Congress. In preparing the recommendations, OMB would be required to consult with the appropriate congressional committees. The Congress would have to enact the recommendations into law for any changes to occur. The intention is to provide flexibility to OMB on the timing of management and financial management reports and permit OMB to eliminate, consolidate, or modify mandated reports that may be outdated, duplicative, or inefficient.

These sections of H.R. 3400 are generally consistent with our view that management and financial reports should be consolidated and streamlined where needed in order to promote more useful and meaningful reporting. We understand the Committee staff is working with OMB to allow a period of time to develop consolidated reports that improve the government's management and financial reporting structure without sacrificing valuable statutory and other required information. We encourage this approach, which would give OMB temporary flexibility to make meaningful reporting changes.

Regarding the simplification of the financial reporting process, the NPR recommends that agency heads be required to provide two reports annually--a planning report and an accountability report--and that any future financial management reporting requirements be addressed in either of these two reports. While H.R. 3400 does not specifically address these kinds of reports, we strongly support financial planning and accountability reporting as the cornerstone of improved federal financial reporting.

We would emphasize, however, the importance of ensuring that any financial reporting changes OMB might propose be consistent with the Objectives of Federal Financial Reporting adopted by the Director of OMB, the Secretary of the Treasury, and the Comptroller General. These objectives focus on accountability and performance reporting for both internal and external users. They were developed by the Federal Accounting Standards Advisory Board (FASAB), established by OMB, the Treasury, and GAO.

ADDRESSING HUMAN RESOURCE MANAGEMENT ISSUES

Several sections in H.R. 3400 and the NPR report relate to how the federal government manages its human resources. The issues raised in those documents range from how many positions the federal government needs to do its work to the degree of centralization needed to direct human resource policies.

One provision in H.R. 3400 would accomplish a widely discussed NPR objective--cutting the federal workforce by 252,000 positions over 5 years. Section 8002 of the bill limits the number of full-time equivalent (FTE) positions in the executive branch in fiscal years 1994 through 1998. By the end of this period, the number of FTE positions would be directed not to exceed 1.851 million--the lowest number of executive branch positions in nearly 30 years.

The bill does not specify how these FTE cuts are to be achieved. Three standard approaches have been used in the past to reduce the size of the workforce--a hiring freeze, a reduction in force, or early retirement. Recently, the Department of Defense and other agencies (including GAO) have been given the authority to offer cash payments to employees who leave voluntarily. Both the House and the Senate have recently passed legislation to extend these "buyouts" to other agencies. Differences in these bills will need to be resolved before the legislation can be sent to the President.

While I support efforts to move to a smaller, more efficient government, I strongly recommend that staff reductions be made in a strategic, well-thought out manner. The fiscal year 1995 budget submitted by the administration does not impose across-the-board reductions but instead targets workforce reductions on an agency-by-agency basis. For example, although the budget proposes that civilian employment in the executive branch as a whole decline by 5.5 percent between 1993 and 1995, the Federal Deposit Insurance Corporation and the Resolution Trust Corporation's (RTC) workforces are scheduled to decline by nearly 30 percent. This reduction is at least partly because RTC is scheduled to go out of existence in 1995. Likewise, the number of positions in the Defense Department is slated to decline by over 8 percent during this period, accounting for nearly 65 percent of the governmentwide 118,300 FTE reduction. On the other hand, some agencies, such as the Department of Justice and EPA, are scheduled to increase their FTE levels between fiscal years 1993 and 1995.

While not reflected in the budget, I believe similar targeting of FTE reductions is needed at the sub-agency level and by occupational category. It is very important that agencies develop well conceived implementation plans to achieve the necessary reductions with minimal impact on agency and program effectiveness. Mechanical across-the-board reductions within agencies can seriously diminish their capabilities to manage resources more productively and deliver services to the public. In sum, the movement to a smaller, more efficient government should be managed carefully, strategically, and rationally.

To be truly effective, changes in federal workforce levels should be carried out in tandem with other management improvement efforts. For example, agencies' reassessments of their missions pursuant to the Government Performance and Results Act may result in changes in organizational structures, reengineering of work processes, and greater use of information technology. These improvements can also affect staffing needs. For example, reductions in the number of positions proposed by the Departments of Agriculture and Housing and Urban Development are expected to be made largely as a result of changes in the departments' regional and field structures. Staffing cuts in other agencies may be made possible through greater use of electronic funds transfers, consolidating and modernizing data processing centers, and other uses of currently available technologies.

Another issue is that many of the NPR report's recommendations regarding federal human resources issues call for federal agencies to assume more responsibility for managing their human resources without central guidance from the Office of Personnel Management (OPM). This theme runs throughout the report, as seen in proposals to give agencies much greater autonomy in recruiting and hiring, determining position classifications and pay rates, and developing incentive award and bonus systems. The proposals also specifically call for redefining OPM's role in human resources management, including delegating its operational work to the agencies. As I said in my testimony last month, these sweeping proposals, while controversial, offer excellent opportunities for serious debate and deliberation.

We agree with the basic premise that agencies should be given the flexibility to manage their own operations to the greatest extent possible. However, it is also clear that many of the requirements that have constrained agency flexibility were the result of legislation that was enacted to support broad national goals such as equal employment opportunity, veterans preference, and merit selection. If agencies are to be given increasing autonomy in managing their human resources, the Congress will need some mechanism for assuring that the legislation and regulations in which these goals are embodied are properly implemented. We strongly believe that this mechanism should aim to assist, not encumber, federal agencies in accomplishing their missions.

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Mr. Chairman, this concludes my statement. The time is right to move to a smaller, more efficient, and results-oriented government. Through the management related sections of H.R. 3400, the administration is trying to change the way the government is managed, and I am very supportive of this broad objective. To help make this goal a reality, I want to reiterate my strong belief in the need to expand the requirement for audited financial statements to all agencies covered by the CFO Act, and for the government as a whole, and to address human resource management issues in a strategic, well thought out manner. I will now be glad to answer any questions the Committee may have.

CFO ACT IMPLEMENTATION: PROGRESS AND BENEFITS TO DATE

The Chief Financial Officers Act of 1990 (CFO Act) ushered in a new era of more effective financial management and increased accountability for the federal government. Through the act's provisions, the Congress sought to bring about the reporting of more accurate and credible financial information by strengthening the federal government's systems, controls, and accountability structures relied on to account for and control hundreds of billions of dollars. In this respect, one of the act's key provisions required selected organizations to prepare and have audited new broad financial management reports. More specifically the act required:

(1) Ten "pilots" to prepare annual financial reports on the overall status of their operations. These are:

-- Departments:	Agriculture Labor Veterans Affairs Housing and Urban Development
-- Military Services:	Army Air Force
-- Agencies:	Social Security Administration General Services Administration Internal Revenue Service U.S. Customs Service;

(2) Other CFO Act departments and agencies to prepare annual financial reports on their revolving funds, trust funds, and commercial-type operations; and

(3) The cognizant inspectors general (IGs), or the Comptroller General at his election, to audit the organizations' annual financial reports.

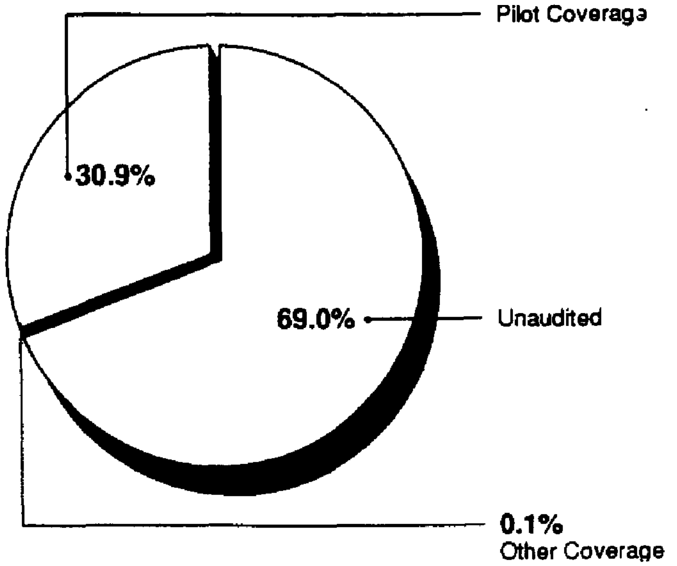
PILOT AUDITS SIGNIFICANTLY INCREASED COVERAGE OF FEDERAL OPERATIONS

The CFO Act significantly increased audit coverage of federal activities. For example, prior to the act, financial statements for the government's primary revenue generating agencies, the Internal Revenue Service (IRS) and the U.S. Customs Service, which collect an estimated $1.1 trillion annually, were not subject to audit. Further, as shown in figure 1, only a small portion of federal spending was audited prior to the CFO Act. More than half of the 23 CFO Act agencies did not have any funds subject to such assessments.

In contrast, figure 1 also shows that after the act's passage, the percentage of budget authority covered by audit requirements almost doubled. This was primarily due to the 10 pilot audits which covered 49 percent of the 23 CFO Act agencies' budget authority in fiscal year 1992. By contrast, audits for revolving funds, trust funds, and commercial activities in these and the other 13 organizations comprised less than 11 percent of the government's budget authority.

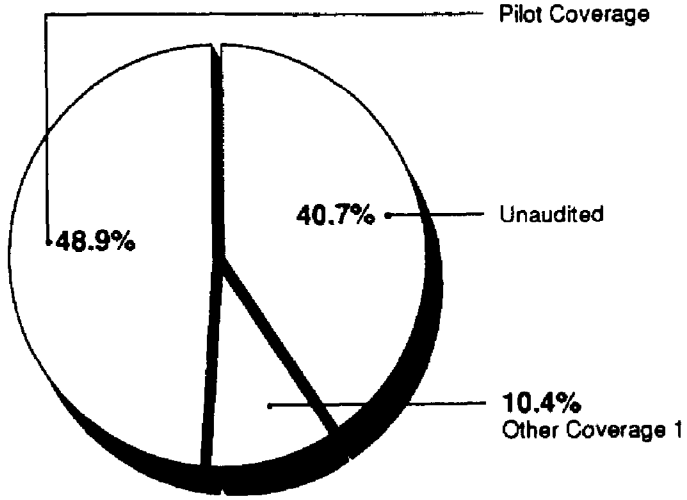
Figure 1: Financial Audit Requirements Coverage

Before the CFO Act



Fiscal Year 1990

After the CFO Act



Fiscal Year 1992

1 Represents revolving funds, trust funds, and commercial activity.

Sources:

Budget of the United States, Fiscal Years 1994 and 1992

Office of Management and Budget - Federal Financial Management Status Report and 5-Year Plan, August 1993

The President's Council on Integrity and Efficiency, August 1993 Report

FINANCIAL AUDITS UNDER THE CFO ACT PROVIDE BROADER SCOPE AND COVERAGE

The scope of audits performed under the CFO Act go far beyond traditional verification of amounts reported in the financial statements. These audits have broad objectives of ensuring full financial accountability and assisting the Congress and federal managers in carrying out their responsibilities by (1) providing reliable and useful information on federal operations, and (2) helping improve a broad range of internal controls and underlying financial management systems. The federal government operates in an environment in which public officials, legislators, and private citizens want, and are entitled, to know not only whether government funds are handled properly and in compliance with laws and regulations, but also whether government entities are achieving the purposes for which they were authorized and funded.

To assist in meeting such objectives, the Office of Management and Budget (OMB) issued guidance on the form and content of federal financial statements. The guidance requires the following:

-- An overview of the reporting entity which provides a clear and concise description of the (1) department or agency, (2) its mission, activities, accomplishments, and (3) its overall financial results and condition. This would include information on whether and how the entity's mission is being accomplished, and specific performance measures showing whether program results are achieving desired outcomes. It would also describe what actions, if any, are needed to improve program and/or financial performance.

-- Principal statements consisting of statements of financial position, operations (and changes in net position), cash flows, and budgetary resources and actual expenses, accompanied by notes to the principal statements which disclose what is necessary to make the principal statements fully informative.

-- Consolidating/combining statements, where feasible and appropriate, which display the information presented in the principal statements according to major programs, activities, or funds.

-- Supplemental financial and management information, where appropriate, which (1) supports information presented in the overview of the reporting entity section, (2) provides information that was not considered appropriate for inclusion in the notes to the principal statements, and (3) offers information that may enhance understanding the financial condition and operations of the reporting entity.

In addition, OMB has issued guidance on auditing federal financial statements that requires that auditors go beyond issuing an opinion only on the financial statements by reporting on the entity's (1) internal control structure and (2) compliance with laws and regulations. Because of the federal government's stewardship responsibilities to its citizens, this guidance emphasizes highlighting internal control problems and assessing how well organizations comply with applicable laws and regulations in delivering services to the American taxpayer.

Further, to help achieve the goals of the CFO Act, we believe the auditor should go beyond the existing audit guidance and determine the affects of any misstatements and internal control weaknesses on (1) the operations of the organizations and (2) the overall accuracy of other financial information--including budgetary and related program information--submitted to the Congress and other decisionmakers. In addition, unlike traditional private sector audits, we believe federal audits should identify the root causes of significant internal control weaknesses found and propose specific actions for correcting them, thus helping to improve operations and financial management.

For example, GAO's audit of the U.S. Customs Service's fiscal year 1992 financial statements determined that internal controls over seized assets were ineffective and that millions of dollars in cash and luxury items and tons of seized illegal drugs were vulnerable to theft and misappropriation because Customs did not adequately safeguard this property. As a result of the extent of our audit work, we were able to describe to Customs the root causes for these conditions and to recommend specific corrective actions, thus empowering Customs to more readily move to resolve these problems.

In enacting the CFO Act, the Congress clearly recognized the federal government's unique environment where broader financial audit requirements are critical to protecting federal funds and other resources and to providing useful information to decisionmakers. These audits should greatly enhance the ability of federal managers to carry out their assigned missions in a way that (1) assures proper accountability over the resources managed, (2) moves toward more economical and efficient operations, and (3) recognizes costs and measures performance.

CFO ACT-MANDATED AUDITS HAVE RESULTED IN MANY BENEFITS

Preparing and auditing the broader financial reports required by the act have highlighted the magnitude of the federal government's financial responsibilities and have resulted in a better understanding of the government's overall financial condition. So far, the CFO Act-mandated audits have shown that significant improvements in accounting systems, controls, and procedures are essential if the federal government is to effectively control its costs, reliably measure and evaluate its performance, and implement today's urgent calls for broader management improvements. The recently completed National Performance Review noted that "vastly improved financial management is critical to the overall effort to reform government..." and, even more tellingly, "Management isn't about guessing, it's about knowing. Those in positions of responsibility must have the information they need to make good decisions."

As discussed in the following sections, the CFO Act has resulted in

-- significantly more accurate and useful information on the government's financial status and its operations;

-- a better understanding of the limited extent to which the Congress and program managers can rely on the financial information they receive;

-- substantial savings of resources through recovery of funds due the government, and more efficient use of funds;

-- an understanding of the extent and pervasive nature of the internal control and financial management systems problems facing the government; and

-- improvements in management's accountability for, and focus on, strong financial management, including the need for effective controls and systems.

More Accurate Information on the Government's Financial Condition and Results of Operations

As discussed in my January 27, 1994, testimony before this Committee, our CFO Act-mandated audits of the IRS and the U.S. Customs Service disclosed that the government has little assurance that it is collecting all the money it is due, or accurately accounting for the estimated $1.1 trillion it does receive annually. For example, GAO's audits showed that:

-- According to IRS's books, the government was owed $110 billion in delinquent taxes and could expect to collect about $30 billion of this amount. However, only about $65 billion was actually owed and, of that amount, IRS could expect to collect only about $19 billion.

-- Because of accounting weaknesses, IRS cannot determine the amount of tax revenues that should be accrued to the excise tax trust funds. Consequently, general fund tax dollars have to be used to subsidize these funds, giving decisionmakers the impression that excise taxes are generating more revenue than they actually do. Over the past several years, such subsidies may have totaled several billion dollars.

-- The Customs Service had little assurance that the government was receiving all duties it was owed because of poor controls over inspections, and overreliance on voluntary reporting by brokers and importers. Weak controls increase the potential for lost revenue and heighten opportunities for drugs and other contraband to illegally enter the United States. In response to our findings, the Customs Service is now reassessing its compliance and collection strategies.

CFO Act-mandated financial audits also have improved available information on costs the government can expect to incur in the future. Without accurate and complete cost estimates for program operations, decisionmakers--including the Congress--do not have the information necessary to make fully informed decisions. In this respect, CFO Act-mandated audits have highlighted, in some cases for the first time, billions of dollars in liabilities and potential losses to the government, which will eventually require the Congress to approve funding. For example:

-- An estimated $190 billion in liabilities for veterans compensation and pension benefits were highlighted as a result of a CFO Act-mandated financial audit of the Department of Veterans Affairs.

-- Liabilities estimated at $122 billion for federal employee post-retirement health benefits were highlighted by a CFO Act-mandated audit at the Office of Personnel Management (OPM).

-- Unfunded liabilities of over $14 billion for the federal employees workman's compensation act program were identified by a CFO Act-mandated audit of the Department of Labor.

-- An estimated $18 billion in potential liabilities associated with hazardous waste disposal and cleanup at Army installations were disclosed by a CFO Act-mandated audit of the Department of the Army.

-- An estimated $13.7 billion in liabilities for loan defaults and interest subsidies were disclosed by an audit of the Department of Education's guaranteed student loan program.

-- About $3.2 billion in accumulated losses for the Department of Agriculture's Federal Crop Insurance Corporation were identified as part of its audit.

-- Increasingly greater projected losses were uncovered at the Federal Housing Administration, with the 1992 financial audit reporting an estimated $15 billion loss.

-- An estimated $3 billion shortfall in the Department of Education's projected program costs for fiscal years 1992 and 1993 were identified by GAO's financial audit.

Conversely, the CFO Act-mandated audit at OPM showed that the government's liabilities of $684 billion for retirement and life insurance programs were actually about $54 billion less than reported by OPM.

<u>Financial Information Used By Decisionmakers Has Limited Reliability</u>

The financial audits performed pursuant to the CFO Act have confirmed that the Congress and program managers can place little confidence and reliance on the information they now receive. We have identified hundreds of billions of dollars of accounting errors--mistakes and omissions that can render information provided to managers and the Congress virtually useless. For example:

-- A fiscal year 1991 financial audit of the Army disclosed that

- adjustments totaling almost $95 billion were needed to correct errors in reported financial data;

- reported financial data excluded almost $11.3 billion in government-furnished property and $400 million in cash on-hand;

- the value of equipment, such as tanks and helicopters, reported at $151 billion, could not be verified; and

- about $18 billion of ammunition inventory held in central storage areas at installations was not recorded in the accounting records.

-- A fiscal year 1992 financial audit of the IRS disclosed that

- approximately $4.3 billion of $6.7 billion in reported expenditures for the year could not be verified;

- seized assets reportedly valued at $797 million could not be verified; and

- while financial reports included $282 million as the value of the agency's property and equipment, budgeted acquisitions for these items for the last 3 years alone were over $450 million.

-- A fiscal year 1992 financial audit of the Customs Service disclosed that

- Customs made over 180 adjusting entries, amounting to billions of dollars to its financial statements. However, Customs could not support or explain many of these entries and some of the balances in the statements were forced. For example, neither the core accounting records nor the subsidiary records supported Custom's reported operating net financial position of about $1.3 billion; this figure was an unsupported "plug" entry to make the Consolidated Statement of Financial Position balance.

- Reported accounts receivable did not include an indeterminate amount of unpaid fines and penalties.

- Property reportedly valued at $9 million could not be verified and many reported equipment values were based on estimates.

- The accuracy of $72 million for intragovernmental receivables and the related $307 million in reimbursable services and user fees could not be verified.

-- A fiscal year 1992 financial audit of the Department of Education's Federal Family Education Loan Program disclosed that

- a $1.1 billion adjustment, of which $433 million could not be supported, was recorded to make the amount of cash reported at the beginning of the fiscal year coincide with Treasury's balance;

- the appropriated capital account had a recorded balance of $15.2 billion at the close of fiscal 1991, when the balance should have been about $50 million; and

- a refunds receivable account was overstated by more than $250 million as of September 30, 1992.

Identifying and quantifying such errors is an essential first step to improving data furnished to managers and the Congress.

Savings, Recoveries, and More Efficient Uses of Funds Are Being Realized

The CFO Act-mandated audits have resulted in actual and potential savings of hundreds of millions of dollars. These savings are derived from increased collections, decreased spending, and resources being used more efficiently. Some examples follow.

-- Customs efforts to revamp its debt collection efforts resulted in the reported collection of over $31 million of severely delinquent debt. This more proactive collection approach has the potential for garnering hundreds of millions of dollars in additional collections.

-- The Department of Education recovered $1.3 million in moneys incorrectly paid to two guaranty agencies which were identified as a result of the fiscal year 1992 financial audit of the Federal Family Education Loan Program.

In addition, the President's Council on Integrity and Efficiency (PCIE) reported[1] the following actual and expected savings in its August 1993 report:

-- About $24 million in overpayments by the Air Force to its contractors were identified and are expected to be recovered as a result of financial statement audits.

-- About $11 million in duplicate payments were identified and are in the process of being recovered as a result of a DOD Inspector General financial audit of the Commissary Resale Stock Fund.

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[1]Task Force on Improved Financial Management and Implementation of the Chief Financial Officers Act, special PCIE project to compile data related to the audit of financial statements, August 1993. The PCIE is a council consisting of federal agency inspectors general.

-- An estimated $15 million in annual savings are expected to be realized as OPM improves its process for managing public accounts receivable by implementing financial audit recommendations.

Agencies also are benefitting from the financial audits through the identification of resources that could be put to better use. For example, in August 1993, the PCIE reported[2] the following.

-- The DOD Inspector General identified an estimated $200 million in invalid outstanding obligations related to DOD's fuel contracts. These funds should have been deobligated and used for other necessary purposes.

-- Naval Audit Service fiscal year 1992 financial audits identified approximately $93.3 million in invalid Military Sealift Command obligations, and an estimated $51.1 million in invalid Navy Defense Business Operations Fund real property maintenance and repair obligations, which should have been deobligated and put to better use.

-- The Army Audit Agency found that Army depot maintenance activities had an estimated $13.7 million in surplus funds accumulated through excessive charges to their customers. These excess funds are to be returned to the activities' customers in the form of lower costs for services.

Audits Surfaced Opportunities to Strengthen Internal Financial Controls and Systems

The financial audits performed under the CFO Act have portrayed a truer picture of the extent and nature of internal control and financial management systems problems facing the federal government. Our work has shown that faulty, poorly functioning financial controls and accounting systems are a primary obstacle to agencies effectively controlling and managing their financial operations. This conclusion was also reached by a PCIE task force on improved financial management and implementation of the CFO Act. Specifically, the task force reported[3] that

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[2] Task Force on Improved Financial Management and Implementation of the Chief Financial Officers Act, PCIE.

[3] Task Force on Improved Financial Management and Implementation of the Chief Financial Officers Act, PCIE.

> "[T]he poor condition of the financial management systems was the greatest difficulty in auditing the financial statements; and the foundation for deterring fraud, waste and abuse starts with cleaning up the financial management systems of the federal government and ensuring the existence of adequate internal controls. Financial statement audits help to impose a discipline that should improve the accuracy of the data within the Federal government's information systems. The knowledge that an annual audit will occur forces management to focus attention on problem areas sooner than they otherwise may have done. The result will not only be accurate financial statements but improved financial systems which produce accurate financial information needed by policy and decision-makers on a daily basis."

The process of preparing and auditing financial statements has resulted in identifying significant internal control and systems deficiencies which were not previously disclosed in organizations' annual Federal Managers' Financial Integrity Act (FMFIA) reporting to the President and the Congress. For example, GAO's audits of IRS, Customs, the National Aeronautics and Space Administration (NASA), and DOD identified the following internal control weaknesses that can now be systematically tracked and monitored for correction as part of the organizations' FMFIA processes.

-- IRS did not disclose material internal control weaknesses in three major areas concerning revenue accounting and reporting, management of operating funds, and reporting and safeguarding of seized assets. GAO also found that IRS' reporting did not disclose the full extent of the weaknesses facing the agency.

-- Five additional areas of internal control and accounting deficiencies were identified at Customs, covering such important areas as seized property, revenues, budgeting, fixed assets, and procurement. In addition, GAO's audit disclosed that Customs did not accurately disclose the severity of the weaknesses it reported.

-- NASA did not accurately characterize or fully disclose extensive internal control and accounting system weaknesses that seriously weakened the agency's ability to safeguard, manage, and control billions of dollars in resources. These weaknesses included inadequate budgetary controls, deficient controls over contractor-held property, and unreliable accounting systems and financial reports.

With respect to DOD, on April 27, 1993, we reported to the Secretary of Defense that the conclusions presented in his department's fiscal year 1992 FMFIA report were at variance with the findings of GAO and other auditors. Specifically, we noted that the department's FMFIA reporting did not adequately highlight longstanding management, internal control, and accounting system deficiencies that weaken DOD's ability to safeguard, manage, and control the hundreds of billions of dollars of resources entrusted to it.

Examples of additional areas in which CFO Act-mandated audits served to focus attention on control and systems problems follow:

-- GAO's IRS audit disclosed weaknesses in the agency's EDP security controls over revenue which include access to taxpayer information and administrative accounting systems used to account for appropriated funds. The audit process reiterated weaknesses that permitted some IRS employees to access income tax information of friends, neighbors, and prominent individuals. IRS is presently focusing on fixes to problems involving unauthorized access to taxpayer information and serious weaknesses regarding the use of its appropriated operating funds that have led to (1) unreconciled differences between its records and Treasury's cash records, (2) unresolved discrepancies and transactions in suspense accounts, and (3) duplicate and other inappropriate payments to contractors.

-- GAO's financial statement audit at the Department of Education revealed the extent to which the department was highly dependent on third party guaranty agencies over which it had little control. As a result, the Department could not ensure that billions of dollars in payments made annually to guaranty agencies and lenders were proper, or that financial information on guaranteed student loan program operations was accurate.

-- GAO's report on its fiscal year 1992 audit of the Department of the Army disclosed that Army personnel received unauthorized payments of over $6 million because of lapses in internal controls.

-- GAO reported that Navy internal control weaknesses resulted in over $12 billion in unmatched disbursements. Unmatched disbursements can be compared to writing checks but not knowing which bills they paid. At the time we reported Navy's $12 billion problem, Defense acknowledged that the total amount of Defense disbursements not properly matched to obligations was about $41 billion.

In addition, certain controls to protect billions of dollars of assets have been improved as a result of CFO Act-mandated financial audits. For example:

-- A financial audit of the Army identified millions of dollars of weapons and equipment, such as expensive helicopter engines and transmissions, that were not properly stored to prevent extensive corrosion which would result in significant repair costs. Since this problem was reported, DOD relocated such assets to protective environments. Also, Defense Logistics Agency personnel are now reviewing all storage decisions to ensure that expensive, fragile, and highly corrodible items are protected against the elements. In addition, as a result of the audit process, DOD's management has initiated actions to improve the accuracy of data recorded in Army's systems related to the types, quantities, and locations of equipment, to better ensure that the government's resources are adequately protected.

-- A financial audit of Army revealed that the Army Material Command, which accounted for about $29 billion of the Army's disbursements in fiscal year 1992, did not retain key financial records needed to support balances shown in the Army's budget execution system. According to Army officials, records for all transactions are now being retained.

GREATER MANAGEMENT ACCOUNTABILITY AND FOCUS ON FINANCIAL MANAGEMENT

It is also important to recognize that the process of preparing financial statements for audit results in numerous benefits which are difficult to quantify, but are nonetheless quite significant. In this regard, the CFO Council--a group composed of agency CFOs and top OMB and Department of Treasury officials--reported in August 1993 that

> "The most frequently reported benefits of preparing audited financial statements are the experience itself, lessons learned from the process, and the discipline of the financial statement preparation effort. Other benefits often mentioned are identification of previously unrecorded or improperly valued assets and liabilities, improved internal controls, improvement in the integrity of financial data, a recognition of the need to correlate proprietary and budgetary accounts, an improved awareness of the need to value ambiguous or indeterminate classes of assets and liabilities, a heightened

awareness of financial management and accounting problems, closer working relationships between the CFOs and the IG's, direction provided to the FASAB in developing needed standards for certain classes of assets and liabilities and an increased awareness of the impact of program managers' resource allocation decisions."[4]

One of the more salient benefits of financial statement audits is the increased emphasis on establishing more disciplined processes and controls that will improve federal operations. For example, in preparing the Army's financial statements, the Defense Finance and Accounting Service made adjustments of about $250 billion and $93 billion, respectively, to the agency's financial records for 1991 and 1992. In addition, the PCIE reported[5] that the Department of Labor financial statement audits have shown their value as a mechanism to discipline underlying systems and that the Environmental Protection Agency foresees enhancing its accounting systems to provide project cost data needed to develop performance measurement information for reporting under the act.

The act also has focused the attention of federal managers at all levels on the need to upgrade the government's basic infrastructure for developing financial information, and on controlling financial resources entrusted to them. For example, the Internal Revenue Service launched a major effort to analyze its operations in order to identify and define the costs associated with specific functions and activities, such as processing tax returns at different locations. Ultimately, the Service's leadership plans to implement "activity based" cost accounting systems, a cost management concept coming into increasing use in governments and in leading private sector organizations. Similarly, financial audit results have helped focus DOD's attention on the need to reengineer its business practices and develop integrated, departmentwide systems to replace the multitude of disparate, non-integrated systems which have developed over time, and which lack any coordinated focus or central control.

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[4]Information on Preparation of Auditable Financial Statements for Fiscal Years 1990, 1991, and 1992, CFO Council Operating Group's Committee on Financial Statement Preparation and Audit, August 27, 1993.

[5]Task Force on Improved Financial Management and Implementation of the Chief Financial Officers Act, PCIE.

In addition, the Army's top leadership has undertaken substantial efforts to increase the agency's emphasis on improving its financial management systems and controls as a result of GAO's financial statement audits. A series of communications from the Office of the Secretary of the Army to commanders in the field have underscored the need to give priority to maintaining effective management controls. Most recently, a January 1994 memorandum from the Under Secretary of the Army to major field commanders concluded that

> "[S]afeguarding America's resources is our responsibility. This ethic must become second nature to every commander and manager. Mission accomplishment depends on it. Effective management controls are the tools we must use in this endeavor. Our challenge is to be worthy of the taxpayers' trust and to make the most of our scarce resources by demanding an environment of empowerment and accountability which results in effective management controls..."

Another significant benefit of the act that cannot be readily measured is that the audits help prevent fraud, waste, and mismanagement that might otherwise occur. The absence of an audit requirement creates, at a minimum, the perception that fraud, waste, and mismanagement may go undetected. This perception occurs because the public, agency personnel, participants and beneficiaries of federal programs, and others become aware that all too often no one verifies that reported information is reflective of the events that actually occurred.

CFO ACT IMPLEMENTATION COSTS

The total reported costs of the CFO Act requirement for the preparation and audit of financial statements for fiscal year 1992 were estimated to be about $111 million. These costs are expected to decline as systems and controls improve, and the agencies' personnel gain more experience in preparing financial statements. Most of these costs were recently reported by OMB, which recognized some difficulties inherent in accumulating such costs. OMB stated that:

> "First, the data in each agency generally come from different data bases. Second, the activities for the preparation and audit of financial statements for a fiscal year occur in that fiscal year and the next fiscal year. Third, much of the CFOs' costs to meet this statutory requirement are

> not new costs. CFOs are responsible for maintaining their agencies' financial data and preparing financial statements, regardless of the statutory requirement for audited financial statements."

Table 1 shows the costs of preparing fiscal year 1992 financial statements and performing the related financial statement audits for each of the 10 pilot agencies, and for over 150 revolving funds, trust funds, and commercial activities covered by the act.

The total costs of preparing fiscal year 1992 financial statements and performing the related audits were only about one-tenth of 1 percent of total budget authority audited.

Table 1: Reported Costs of Preparing and Auditing CFO Act Financial Statements in Fiscal Year 1992

DEPARTMENT/AGENCY REPORTING ENTITY	AUDIT COSTS (in millions) Preparation **	Audit***	TOTAL AUDIT COSTS (in millions)
DEPARTMENTS/AGENCYWIDE PILOTS *			
HHS	$3.3	$2.8	$6.1
Defense	2.5	29.7	32.2
Agriculture	2.2	6.0	8.2
Veterans Affairs	0.7	2.2	2.9
Labor	1.2	5.3	6.5
HUD	3.9	1.9	5.8
Treasury	2.8	12.5	15.3
GSA	0.2	0.9	1.1
SUBTOTAL	16.8	61.3	78.1
15 Other Departments or Agencies	7.6	14.5	22.1
Total Direct Costs	24.4	75.8	100.2
Indirect Costs	5.9	5.0	10.9
TOTAL COSTS	$30.3	$80.8	$111.1

* The CFO Act mandates that 10 departments/agencies serve as "pilots". All but HHS, Defense, and Treasury were departmentwide audits. Within these Departments, the agencies audited included Social Security Administration, the Army, the Air Force, the Internal Revenue Service, and U.S. Customs Service, respectively.

** Source: The June 30, 1993 Council Operations Group Committee on Financial Statement Preparation and Audit Report

*** Source: The President's Council On Integrity and Efficiency August 1993 Report and the Office of Management and Budget's November 17, 1993 Report on the Preparation and Audit of Financial Statements

Costs Are Expected to Decline

Future declines are expected in the costs of preparing and performing audits of federal financial statements based on historical audit experience in both the public and private sector. Some of these costs have already declined based on recent reports by Inspectors General and Chief Financial Officers. The PCIE's August 1993 report by the Inspectors General states that

> "[T]he first year or two of an audit traditionally costs more than subsequent years because the auditor must obtain an understanding of the reporting entity's operations, identify the controls in place, and establish reliable beginning balances. Audit costs have already begun to decline for several audits initiated in fiscal years 1990 and 1991."

Some examples of costs savings in second year or subsequent audits of federal agencies or programs follow.

-- The costs of second year audits performed by GAO under the act for fiscal year 1993 are expected to decline by at least 40 percent.

-- At Agriculture, with several years of audit experience, the Inspector General plans to reduce 1993 audit costs by over $1 million from the fiscal year 1992 audit.

-- The 1992 audit costs at the Social Security Administration decreased by over $100,000 from the fiscal year 1991 audit.

In addition, with regard to costs of preparing financial statements, the Chief Financial Officers Council Operations Group reported to OMB in August 1993, that

> "[M]ost CFOs report that they expect financial statement costs to gradually decline as their agencies move further along the experience curve of preparing the statements."

This reduced cost should result from improved records and more capable personnel at the agencies. Some agencies have already had declines in their costs of preparing financial statements after the first year's efforts. For example, according to the PCIE report, the Department of Justice reported that the cost of preparing statements decreased from about $590,000 for fiscal year 1991, to about $272,000 for fiscal year 1992.

Other Cost Considerations

When considering the incremental costs of the audits mandated by the act, one should consider (1) the necessary work that would have been performed by the inspectors general even if audits were not required and (2) the savings generated from the audits.

Inspectors general often perform work that is similar to that done in a financial audit that could be incorporated into the audit, allowing this type of work to be deferred and in some instances eliminated. Also, in several instances, savings attributable to audit findings exceeded the costs of the audits. Many of these financial savings achieved by agencies covered by the act were previously discussed, demonstrating that hundreds of millions of dollars of such savings have already been realized.

CONCLUSIONS

The act's first 3 years clearly represent a very successful start, and demonstrate the relevance of its provisions to improving government operations. Accurate and reliable cost information and performance data are essential if the executive branch and the Congress are to make informed decisions on the budget, tax policies, and the overall direction of government programs. Audited agency financial reporting provides an annual assessment of whether agencies achieved what they claimed to have achieved and whether funds were spent as authorized by the Congress--which, in the end, provides the accountability expected by the public.

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